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In The

Supreme Court of the United States

October Term, 1997

BANK OF AMERICA NATIONAL TRUST AND SAVINGS ASSOCIATION, SUCCESSOR BY MERGER TO BANK OF AMERICA ILLINOIS,

Petitioner,

v.

203 NORTH LaSALLE STREET PARTNERSHIP,

Respondent.

On Writ Of Certiorari To The United States Court Of Appeals For The Seventh Circuit

BRIEF FOR RESPONDENT

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QUESTION PRESENTED

Does 11 U.S.C. Section 1129(b)(2)(B)(ii) prevent confirmation of a plan of reorganization under the terms of which all of the reorganization value of the insolvent debtor has been given to creditors, simply because old equity holders retained an interest in the entity for which they paid fair equivalent value?

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STATEMENT

I. Introduction

Fundamentally, a plan of reorganization under Chapter 11 of the Bankruptcy Code (11 U.S.C. §§ 101 *et seq.)* effectuates an *exchange* of old pre-petition claims and interests for new rights under a confirmed plan.[1] A plan must "provide adequate means for the plan's implementation, such as – issuance of securities . . . *for cash*, for property, for existing securities, *in exchange for claims or interests*, or for any other appropriate purpose." Section 1123(a)(5)(J) (emphasis added). There is nothing in the Code which dictates or restricts the source of funding for a plan.[2] Reorganization benefits creditors by preserving or creating value that would not otherwise be available in a foreclosure or forced liquidation. *United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983).

The Code gives the debtor the exclusive right to propose a plan during the first 120 days of the case. Section 1121(b). Parties in interest may show cause to reduce or increase that exclusive period.[3] Section 1121(d). The role of the bankruptcy court in the plan confirmation

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[1] Hereafter, unless otherwise noted, all Section references will be to the Bankruptcy Code, 11 U.S.C. §§ 101 *et seq. ("Code")*. "Pet. Br." refers to Petitioner's brief on the merits. "SG Br." refers to the brief of the Solicitor General as amicus curiae. "Pet. App." refers to the Appendix to Petitioner's Petition for Issuance of a Writ of Certiorari. "J.A." refers to the Joint Appendix.

[2] In this case, the Debtor's plan of reorganization (the "Plan") was funded by a capital call on the Debtor's partners.

[3] Parties in interest are defined in Section 1109 as "including" the debtor, the trustee, a creditors' committee, an equity security holder or an indenture trustee. Section 102(3) provides that "includes" and "including" are not limiting.

process is clearly set forth in Section 1129. Relevant to the issue in this case – the interpretation of Section 1129(b)(2)(B)(ii) – the Code restricts the bankruptcy judge's role to resolving conflicts between classes of creditors which have voted to accept the proposed plan and classes of creditors which have voted to reject the proposed plan.

In this case there was such a conflict. Two impaired classes of unsecured creditors disagreed over the Plan. One class of unsecured trade creditors voted to accept the Plan; the other, the class whose only member – the Petitioner ("Bank") – held an artificially created unsecured claim which existed only by virtue of Section 1111(b), voted to reject.

When classes disagree over whether to accept a plan, the Code *requires* the bankruptcy court to resolve the conflict and confirm the plan, if all of the requirements of Section 1129(a), other than Section 1129(a)(8) (requiring that each impaired class accept the plan) have been satisfied, and if the plan is "fair and equitable" with respect to the dissenting class. Section 1129(b)(1).[4] The plain language of the Bankruptcy Code prevents the dissenting class from depriving assenting creditors of the substantial benefits which may flow from a reorganization. The statutory mandate that the bankruptcy court override the vote of a dissenting class and confirm such a plan is known as "cramdown."

The statutory mandate to "cramdown" a plan upon dissenting classes of unsecured creditors, which the court

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[4] There is nothing in the Code which requires or permits the court to consider the number or amount of claims in the dissenting class, relative to the number or amount of claims in the assenting class, in determining whether a plan is "fair and equitable".

determines to have been treated "fairly and equitably," *requires* the bankruptcy court to second guess dissenting creditors' judgment. Section 1129(b) requires the bankruptcy court (rather than one of the parties to the dispute) to adjudicate the controversy and to use Section 1129(b) as its standard. A dissenting class, whose rights in an insolvent debtor's assets have been protected relative to subordinate rights of junior classes, has no right to "spoil the party" for assenting classes of creditors.

It is abundantly clear that the slogans scattered throughout the briefs of the Bank and its amici are oversimplifications which are patently inconsistent with the plain language of the Code.[5] Congress has explicitly directed the bankruptcy judge to bind dissenting creditors, whom the judge determines have been treated fairly and equitably, to a plan of reorganization. Any holding which has the effect of disrupting that coherent statutory scheme would be judicial legislation.

II. Factual Background

The Plan, which has been in effect since December 6, 1995, gives the Bank all of the cash flow and future

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[5] Examples of such slogans are: "Creditors effectively own bankrupt firms . . . and whether creditors would be better off under a proposed plan of reorganization is a determination . . . for creditors to make." (Pet. Br. at 41-2 (internal quotation marks omitted).); and "The new value exception also improperly injects the judiciary into what should be creditors' business decisions. . . . The new value exception reverses the roles of creditors and courts." (Pet. Br. at 44.) With respect to the slogan that creditors effectively own bankrupt debtors, *see Whiting Pools*, 462 U.S. at 211 (Case involving the Internal Revenue Service as a secured creditor holding a tax lien in which the Court held, that until a transfer of ownership at a tax foreclosure sale is complete, the property remains the debtor's.).

appreciation from the reorganized debtor's ("Reorganized LaSalle") office building (the "Property") until the Bank has received payment in full of its secured and unsecured claims, aggregating $93 million.[6] The Bank's opportunity to benefit from that future appreciation, which the Bank agrees will occur, is facilitated by a $6.125 million new capital contribution from certain of the former Debtor's partners ("Investors"). The Plan provides that the Investors can receive no return whatsoever on or of their investment until the Bank has been paid in full. The Investors made the new capital contribution to defer the tax liability they would have incurred if the Bank had foreclosed on its mortgage.[7] (Pet. App. at 112a-113a.)

The Bank's note was nonrecourse, requiring the Bank, under nonbankruptcy law, to look only to the Property for payment. Therefore, in a foreclosure, the Bank would have received only the depressed value of the Property at the time of the foreclosure sale.[8] In a Chapter 7 liquidation, the Bank's deficiency claim would have been disallowed as unenforceable under applicable nonbankruptcy law. (Pet. App. at 128a.) However, in this Chapter 11 case, pursuant to Section 1111(b)(1)(A), the

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[6] As described below, the Plan preserves the Bank's deficiency claim in its entirety until that claim has been paid in full. Since the effective date of confirmation of the Plan, the principal amount of the secured loan has been paid down by over $5 million.

[7] The Plan eliminated the interests of non-contributing partners. Partners who did contribute new capital received equity interests in Reorganized LaSalle proportionate to their contributions. Over sixty percent of the partnership interests changed hands upon confirmation of the Plan.

[8] Federal banking law requires banks to dispose of saleable foreclosed properties within five years. 12 U.S.C. § 29.

Bank was entitled to be treated as if it had recourse against the Debtor. The Bank had a right, under Section 1111(b)(2), to retain a lien upon the Property for its full $93 million claim. But for tactical reasons, the Bank chose not to exercise that right.[9] As a result of the Bank's choice, under Section 506(a) and Bankruptcy Rule 3012, the Bank's claim was split into two claims: (a) a secured claim equal in amount to the value of the Property and (b) an artificially created unsecured deficiency claim for the balance of the Bank's loan. In order to determine the amount of the Bank's secured claim, the bankruptcy court was *required* to value the Property. *In re Sandy Ridge Development Corp.*, 881 F.2d 1346, 1354 (5th Cir. 1989) ("Although we recognize that property valuation is not an exact science, it remains an integral part of the bankruptcy process."). The Bank's $54.5 million secured claim was based on the bankruptcy court's valuation of the Property at $55.8 million, less the disposition costs which the Bank would have incurred if it had sold the Property after foreclosing on its mortgage. (Pet. App. at 115a.) *There was no material difference between the Bank's and the*

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[9] Obviously, the Bank, a secured creditor, made that choice to permit it to cloak itself in unsecured creditor's clothing with standing to invoke Section 1129(b)(2)(B)(ii). Under the circumstances, it is cynical for the Bank to represent that unsecured creditors have decided their own financial interests by a majority vote. It is significant that neither the Bank nor any of its amici really represent the interests of genuine unsecured creditors. The actual interests of real unsecured creditors are represented in this case by the amicus briefs of the National Association of Credit Management and the twenty regional Credit Associations who have joined as amici with the Commercial Investment Real Estate Institute, the National Apartment Association, and National Small Business United filed in support of Respondent.

bankruptcy court's valuation of the Property. The bankruptcy court's value for the Property was a mere 2.8% less than the value proposed by the Bank's appraiser. (Pet. App. at 108a, 111a.)

General Electric Capital Corporation ("GE"), in a letter of intent for refinancing the Property, offered to lend Reorganized LaSalle $54.5 million with which to immediately pay the Bank's secured claim in cash, in full. (Pet. App. at 125a-126a.) The Bank refused to accept that cash payment, or any plan which would have permitted the Debtor to retain ownership of the Property. (Pet. App. at 126a.) Therefore, in order to confirm its Plan, the Court was required to "cramdown" the Plan on classes containing the Bank's secured and unsecured claims by satisfying the requirements of Sections 1129(b)(2)(A)(i) and 1129(b)(2)(B)(ii).

The Plan treated the Bank's secured claim more favorably than the treatment required by the market place as evidenced by GE's letter of intent. Thus, although the Bank voted its secured claim to reject the Plan, the bankruptcy court found that the Plan's treatment of that claim satisfied the requirements of Section 1129(b)(2)(A)(i).[10] (Pet. App. at 172a.)

As required by the Seventh Circuit's decision in *In re Woodbrook Associates*, 19 F.3d 312, 319 (7th Cir. 1994), the Plan placed the Bank's artificial deficiency claim in a class by itself. Under the Plan, the Bank's artificial deficiency claim receives all proceeds from a sale or refinancing of the Property remaining after payment of the Bank's secured claim, until that deficiency claim is paid in full. (Pet. App. at 132a-133a.) The bankruptcy court projected that a sale or refinancing of the Property on the tenth

[10] The Bank has not appealed that finding to this Court.

anniversary of plan confirmation would produce a $19 million distribution to the Bank on account of its deficiency claim, representing a 16% dividend on a present value basis. (Pet. App. at 133a.) If the Property is refinanced rather than sold on or before the tenth anniversary of confirmation of the Plan, the potential exists for the Bank to receive an even greater dividend when the Property is refinanced again or sold after the tenth anniversary of Plan confirmation.[11]

The Bank was not the only creditor in this case. General unsecured trade debt of about $160,000, held by forty five creditors, was paid in full pursuant to the Plan. (Pet. App. at 103a, 132a.) The general partner of the Debtor and an affiliate held additional unsecured claims, allowed by the bankruptcy court, totaling $7.7 million; the general partner held another claim secured by a $11.3 million second mortgage. (Pet. App. at 103a, 129a.) Under the Plan, the general partner and its affiliate waived their unsecured claims, even though the $7.7 million of unsecured claims held by the general partner and its affiliate would have received a distribution of approximately $3 million under Chapter 7. (Pet. App. at 129a-130a.) Under the Plan, that money was reinvested in the Property. The Plan fully subordinated the new capital contribution to the Bank's artificial deficiency claim. (Pet. App. at 135a.)

Prior to confirmation of the Plan, the Bank filed a motion in the bankruptcy court seeking to terminate the Debtor's statutory exclusive right under Section 1121(b)

[11] The Plan does not reduce the Bank's deficiency claim. Thus, if the first mortgage is paid through successive refinancings, the deficiency will continue to exist and the potential exists for the Bank to benefit from those refinancings until its deficiency claim is paid in full.

to file a plan. The Bank also sought leave to file its own plan that called for liquidation of the Property, and made no provision either for contribution of new capital or for any payment to the $7.7 million of allowed unsecured claims held by insiders. The bankruptcy court denied the Bank's motion. The Bank did not appeal that denial or raise that denial as an issue on appeal.

Following confirmation of the Plan, the Bank moved both in the bankruptcy court and in the district court for a stay pending appeal. (J.A. at 7, 12.) The Bank refused to post a supersedeas bond. (J.A. at 8, 13.) As a result, its motions for stay pending appeal were denied and the Plan was implemented.

SUMMARY OF ARGUMENT

The Plan in this case satisfied the plain language of Section 1129(b)(2)(B)(ii). That section provides that the holder of a junior claim or interest may not, over the dissent of a class of senior interests, "receive or retain under the plan on account of such junior claim or interest any property." This is the so-called absolute priority rule *and* its new value corollary. By its very terms, Section 1129(b)(2)(B)(ii) does not prohibit a reorganization plan from providing that the holders of junior interests – such as the Investors here – purchase an interest in the reorganized entity. The absolute priority rule states only that if a senior class dissents, the owners may not receive this interest "on account of" their junior interest.

Here, the Investors did not receive any property under the plan "on account of" their junior interest in the debtor. They received their interest in Reorganized LaSalle "on account of" – that is, in exchange for – their payment of $6.125 million in cash. Under the Plan, only partners who paid cash received "property" in the reorganized

firm. Partners who did not pay – and there were many – received no property at all, and their interest was wiped out.

The Bank refers repeatedly to the "new value exception" and trumpets that the Code contains no such "exception." This argument, so prominent in the Bank's brief, is a red herring. It is part of the Bank's sustained effort to divert the Court's attention from the plain language in Section 1129(b)(2)(B)(ii) – such as the phrase "on account of" – an effort that fatally undermines the Bank's position.

We fully agree that there is no exception to the absolute priority rule – the court of appeals did not create one, and we do not seek one. The absolute priority rule itself, by its terms, simply does not apply to a reorganization plan when the old equity holders receive their interest in the new firm in exchange for – "on account of" – their payment of new value. That is what occurred here. Solicitor General Robert Jackson – taking a position that, as we explain below (see pages 35-36), his successor inexplicably abandoned 59 years later – referred to a new value "corollary" to make this point about the absolute priority rule, and for convenience we use Solicitor General Jackson's term. But the term "new value corollary" should not be taken to suggest that our position requires anything other than a literal application of the language of Section 1129(b)(2)(B)(ii). Similarly, the Bank tries to create the impression that the new value corollary was invented by a dictum in *Case v. Los Angeles Lumber Products Co.*, 308 U.S. 106, 119-121 (1939).[12] This, too, is false. This Court has recognized for at least eighty-five years –

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[12] The Bank argues that the Court's recognition of the corollary in *Case* is *dicta*, because it was allegedly unnecessary to the decision. (Pet. Br. 33-34.) But, there would have been no need to address the requirements of the corollary in *Case*, if the corollary did not exist.

since *Northern Pac. Ry. Co. v. Boyd*, 228 U.S. 482 (1913) – that the absolute priority rule is not violated when equity holders retain an interest in exchange for payments of cash. The *holding* of *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926), is that a plan containing such a feature is valid. The dictum in *Case* that so preoccupies the Bank referred to an aspect of bankruptcy law that was already well established at the time of *Case*.

The Bank's position, in short, would require the Court *both* to read the phrase "on account of" out of the statute – or give that phrase an implausible meaning – *and* to discard an approach that has been an accepted part of bankruptcy law for eight decades. Nothing that the Bank or its amici say remotely justifies such a drastic step.

The Bank's brief conspicuously strains to avoid having to come to grips with the phrase "on account of" – a phrase that the Bank never even defines. Instead the Bank places inordinate emphasis on the argument that the Plan provides for the prospective investors to receive "property," for which they did not pay.

The Plan obviously does provide that the Investors will receive property: they will receive an interest in the reorganized firm. But the Bank, bizarrely, insists that "the purchased equity interest" is *not* "the property interest provided by the plan" (Pet. Br. at 20.) – even though, of course, the Plan provides precisely that the investors will "receive" (in the language of Section 1129(b)(2)(B)(ii)) a "purchased equity interest." The reason the Bank tries to ignore this "property" is apparent. This is, in the Bank's own revealing words, a "*purchased*" equity interest: the investors received this property because they purchased

it for new value; they received it "on account of" their contribution of $6.125 million in cash.

Instead of focusing on the purchased property that the Plan really *does* distribute – a focus that would reveal the utter weakness of the Bank's position – the Bank tries to change the subject to a chimerical form of property that the old partners do *not* receive under the Plan. The Bank asserts, repeatedly, that the Plan gives the old partners "the exclusive opportunity to retain an equity interest in [the] business enterprise." (Pet. Br. at 15.) But the Plan did not give the old partners an "opportunity" or option in any form. The Plan *required* that they pay $6.125 million, in exchange for which those who invested received an interest in the reorganized firm. Once the Plan was approved by the bankruptcy judge, the Investors had no options or opportunities whatsoever: they faced a $6.125 million liability.

Casting aside the language of Section 1129(b)(2)(B)(ii), the Bank repeatedly insists that the Investors here received "special treatment" on account of "their status." (Pet. Br. at 20, 21.) But the "special treatment" that the Bank inveighs against is the debtor's exclusive right to propose a plan during the first 120 days. That right is specifically provided for in the statute. Section 1121. The "property" that the investors received "under the plan" was property for which they paid.

The Code made no change to the substance of the "fair and equitable" rule when it codified the "fixed principle" of *Boyd*, as interpreted in *Kansas City Terminal*. The Code merely changed the standing requirement of the party in interest who could invoke the absolute priority rule from a dissenting individual (under the Act) to a dissenting class. The content of the rule remained the same.

The new value corollary is consistent with the purpose of Chapter 11, which is to maximize realizable value of the assets of a Chapter 11 debtor for all of its creditors. It has never been the law, either under the Code or previous reorganization law, that a non-assenting creditor, such as the Bank, has complete veto power over a reorganization. Moreover, the fact that judges may not always perfectly perform their statutory valuation duties under the Code, does not justify ignoring the Code's clear requirement that the bankruptcy judge value collateral for "cramdown" purposes.

ARGUMENT

I. The Plan Satisfies the Plain Language of Section 1129(b)(2)(B)(ii).

A. "On account of," in the context of Section 1129(b)(2)(B)(ii), means "in consideration for" or "in exchange for."

A key phrase in Section 1129(b)(2)(B)(ii) is "on account of." For the reasons set forth below, that phrase means "in consideration for," or "in exchange for." As explained above, reorganization involves an exchange of old pre-petition claims and interests for new rights under a confirmed plan. In this case, creditors paid for the property they received under the Plan by exchanging their pre-petition debt for that property. In contrast, pre-petition partners were not permitted to pay for their retained interests by exchanging their pre-petition partnership interests. The Plan specifically provides:

> The partnership interest . . . of any partner who fails to make the foregoing required contribution or any part thereof, *shall automatically be deemed terminated*.

(J.A. at 39 (emphasis added).) Accordingly, the equity interests of pre-petition partners who did not respond to the capital call were wiped out. In the Bank's own words, Investors "purchased" (Pet. Br. at 20.) the interests which they retained under the confirmed Plan with $6.125 million in fresh cash.

The Oxford English Dictionary, 2d edition (1989), states that the phrase "on account of" is derived from the business phrase "on account", which means, "as an item to be accounted for at the final settlement, in anticipation of or as a contribution to final payment, as an interim payment on account of something in process." That dictionary defines "on account of" as "in consideration of, for the sake of, by reason of, because of." "In consideration of" is listed as the first definition of "on account of" in deference to the expressly mercantile origins of the phrase. A reorganization plan, of course, itself speaks the language of a business exchange – classes of creditors and equity holders are offered something in exchange for their pre-petition claims and interests. For this reason, the most natural meaning for "on account of" in the context of Chapter 11 is, "in consideration of", "in exchange for" or, if you will, "in satisfaction of."[13] Moreover, this meaning affords guidance to courts in interpreting the statute.

The Bank's arguments that the Plan violates Section 1129(b)(2)(B)(ii) are flawed because they ascribe an unnatural and unworkable meaning to that phrase, by

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[13] The Court recognizes that statutory language, like other language, should be read in context. *Textron Lycoming Reciprocating Engine Division v. UAW*, ___ U.S. ___, 118 S. Ct. 1626, 1629, 140 L.Ed.2d 863 (1998). Context consists not merely of other sentences, but also of the real world situation to which the language pertains. *In re Handy Andy Home Improvement Cntrs., Inc.*, 144 F.3d 1125 (7th Cir. 1998).

requiring application of a "but for" causation test. The Bank's "because of" reading fails to reflect the reality of the exchange which occurs in a reorganization. Requiring application of a causation test leads to arguments about "degrees of causation" which simply cannot be what Congress intended. Congress could not possibly have meant the application of the absolute priority rule to turn on a vague and formless Aristotelian inquiry, exemplified at Pet. Br. pp. 21-22, into whether the equity holders' prior interest was the "cause" of their retention of equity in Reorganized LaSalle. However, even if the phrase implies causation, "proximate cause" is the proper test. Properly interpreted, the Investors retained no property under the Plan "on account of" their pre-petition equity interests.

One searches the Bank's brief in vain for a definition of "on account of" – the phrase which is the pivot upon which the Bank's whole argument turns. The Bank assumes, without discussion, that the phrase requires a "but for" causation inquiry. The Solicitor General (SG Br. at 11-12) explicitly states that the phrase means "for," "because of" and "by reason of," thereby also ascribing a "but for" meaning to that phrase.[14] But, at the urging of the Solicitor General, the Court recently refused to ascribe a "but for" meaning to the phrase "on account of" in the Internal Revenue Code, instead adopting an interpretation of those words that "impose[s] a *stronger causal connection*." *O'Gilvie v. United States*, 519 U.S. 79 (1996)

[14] The Solicitor General also explains away "on account of" as a Congressional attempt to make clear that junior creditors who also have senior claims can receive property "on account of" their senior claims. (SG Br. at 15) Surely, if that is what Congress intended, it would have expressly said so, and there would be some reference to that intent in the legislative history.

(emphasis added).[15] The underlined words of the Court in *O'Gilvie* are almost identical to the underlined phrase used by the Seventh Circuit, in this case: "Congress, in using the 'on account of' language, might well have intended *a more direct causation*. . . . [than that urged by the Bank]" (Pet. App. at 17a (emphasis added).) *See also, In re Bonner Mall Partnership*, 2 F.3d 899, 909 (9th Cir. 1994), *cert. dismissed*, 513 U.S. 18 (1994) ("A reading of the full text of section 1129(b)(2)(B)(ii) makes it clear that what Congress had in mind was a direct or immediate causation rather than a more remote variety. . . . ").[16] Explicitly defining "on account of" to mean "but for" causation leads the Solicitor General, as it must, to a conclusion which is too rich even for the Bank's blood – that equity holders can *never* have an interest in a reorganized debtor over the dissent of a class of senior creditors which is not being paid in full.[17] Recognizing how

[15] In his brief in that case, using the same dictionary definition as he used in this case, the Solicitor General urged the Court to reject a "but for causation approach" and cited the following language from *Reese v. United States*, 24 F.3d 228, 230 (Fed. Cir. 1994) with approval in support of his position: "[t]he language 'on account of' is not free of ambiguity; rather it is susceptible of *at least* two conflicting interpretations." 1996 Westlaw 325323 at 16 (emphasis added). In that brief, the Solicitor General argued that "sufficient" [or proximate] cause is the proper interpretation of "on account of." *Id.* at 17.

[16] The phrase "on account of" is peppered throughout the Code. The phrase can be properly defined only in the context of the section in which it is used. Every time the phrase is used in Section 1129, its most natural meaning is "in exchange for." 1129(a)(7)(A)(ii)(B); 1129(a)(9)(A); 1129(a)(9)(C); 1129(b)(2)(A)(i)(II); 1129(b)(2)(B)(i); 1129(b)(2)(B)(ii); 1129(b)(2)(C)(i) and 1129(b)(2)(C)(ii).

[17] That prohibition would, of course, apply as well to retention of any interest by junior creditors, such as subordinated debenture holders.

radical that view is, the Bank distances itself from the Solicitor General by pointing out (Pet. Br. at 11) that the Court is not required to address the Solicitor General's argument.[18] If the meaning of "on account of" in Section 1129(b)(2)(B)(ii) were as clear as the Bank would have the Court believe, surely the Bank and its amici would be able to agree on the consequences of that language.

The Solicitor General candidly acknowledges the inevitable consequences of ascribing a "but for" meaning to "on account of," i.e. junior claim and interest holders can *never* participate in a reorganized debtor over the objection of a class of unpaid senior unsecured creditors. That conclusion is inescapable, because possession of a pre-petition claim or interest will always, no matter how remote, be a link in the chain of causation leading back from participation in the reorganized entity. But, adopting the Solicitor General's interpretation would require the Court to overrule its seminal cases which established the existence and contours of the absolute priority rule: *Northern Pac. Ry. Co. v. Boyd*, 228 U.S. 482 (1913) and *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 271 U.S. 445, 455 (1926).[19]

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[18] The same arguments were made by previous Solicitors General in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197 (1988) and *Bonner Mall*, 2 F.3d at 899.

[19] The Bank and the Solicitor General attempt to escape this conclusion by mis-characterizing *Kansas City Terminal* as a case where senior (i.e. *secured*) creditors consented to old equity's continued participation. That consent was irrelevant to the Court's decision, which approved old equity's participation in exchange for a contribution of necessary new capital over *unsecured* creditors' dissent.

No reason is given why the Court should overrule those cases, which constitute the bedrock of reorganization law. Surely if Congress had intended to overrule those cases, by the oblique method of ascribing a "but for" causation meaning to the commercial term "on account of," some mention of that intention and those cases would have appeared in the legislative history. *Kelly v. Robinson*, 479 U.S. 36, 47 (1986) (When Congress intends to change the interpretation of a judicially created concept, it makes that intent specific.)

In *Boyd*, the Court recognized that old equity holders could participate in a reorganized entity over the objection of an unpaid unsecured creditor by making a "fair offer." *Boyd*, 228 U.S. at 508. In *Kansas City Terminal*, the Court defined an offer as "fair" if it involved a *cash* contribution from old equity holders which was essential to success of the reorganization.[20] 271 U.S. at 455.

This Court has held that the phrase "fair and equitable," "is a term of art used to indicate that a plan fulfills the necessary standards of fairness." *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106, 118 (1939). The Court recognized that those standards were established, *inter alia*, in *Boyd* and *Kansas City Terminal*. *Id.* at 115. Adoption of the rule advocated by the Solicitor General would fundamentally alter the meaning of the phrase "fair and equitable," as Congress used that phrase both in Section 1129(b)(1), and in the predecessors to that Section, Section 221(2) of Chapter X, 11 U.S.C. § 621(2) (1970) (repealed) and Section 77B(f), 11 U.S.C. § 205(e) (1934) (repealed). Neither the Bank nor the Solicitor General has

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[20] By requiring that the "fair offer" be an offer of cash, the Court reaffirmed its ruling in *Boyd* and ruled that so called "give-up" plans were not "fair offers."

suggested any valid reason why this Court should usurp the role of Congress and legislate a radical change in the meaning which Congress has ascribed to the phrase "fair and equitable" for nearly 65 years.

The Solicitor General is incorrect when he states (SG Br. at 22-23) that the meaning ascribed by the Court of Appeals to the phrase "on account of" would allow for "give up" plans.[21] This error results from misunderstanding the relationship between Section 1129(b)(2)(B)(ii) and use of the term "fair and equitable" in Section 1129(b)(1).

Section 1129(b)(1) provides that a cramdown plan must be confirmed if it is "fair and equitable" with respect to impaired dissenting classes. Section 1129(b)(2) goes on to provide, "the condition that a plan be fair and equitable *includes* the following requirements." (emphasis added) Section 102(3) states that " 'includes' and 'including' are not limiting."[22] Section 1129(b)(2)(B)(ii) describes only one set of circumstances which will *prevent* a finding

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[21] The Solicitor General's definition of a "give up" plan (SG Br. at 22) is incomplete. The definition omits the crucial element of a "give up" plan, which is that the junior class to which property was allocated by senior claim holders did not pay fair equivalent value for the interest received. The interest was "given up" to them as a gift by senior claim holders. The Solicitor General used this tactic to avoid the precedential effect of the *Kansas City Terminal* decision, which approved a new value cramdown plan.

[22] The legislative history of Section 1129(b) reveals that many well-settled aspects of the fair and equitable requirement, e.g. the rule that creditors in a senior class not receive more than 100 percent of their claims, were omitted from Section 1129(b)(2) merely to avoid unnecessary complexity, and not to effect any change in the substance of the rule itself. 124 CONG. REC. 32,407 (1978) (statement of Rep. Edwards); *Id.* at 34,006 (1978) (statement of Sen. DeConcini).

that a plan of reorganization is "fair and equitable" with respect to a class of dissenting unsecured claims. In other words, the "fair and equitable" requirement of Section 1129(b)(1) is broader than the prohibition of Section 1129(b)(2)(B)(ii). Accordingly, since "give up" plans have been prohibited since *Boyd*, because they were held not to be "fair," they are also prohibited as "unfair" under Section 1129(b)(1), irrespective of whether such plans pass muster under Section 1129(b)(2)(B)(ii).

Moreover, the Solicitor General's description of *Kansas City Terminal* as a "give up plan" (SG Br. at 23 n. 24) is inaccurate. In *Kansas City Terminal*, senior creditors did not "give up" or gift a portion of their value to former equity holders. Old equity paid cash in exchange for its participation in the reorganized entity. *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 28 F.2d 177, 187 (8th Cir. 1928) (after remand from the Supreme Court). The Court ruled that the plan satisfied the "fixed principle" of *Boyd*, and was fair and equitable with respect to dissenting unsecured creditors who were not paid in full.

Even if the Court should conclude that "on account of" means only "because of," the Court should interpret that phrase to require application of a proximate, direct cause test, and should not be led astray into the metaphysical maze of the "but for" inquiry advocated by the Bank. The Courts of Appeals in this case and in *Bonner Mall*, 2 F.3d at 909, correctly opted for a direct, or proximate, cause interpretation of "on account of."

Courts do not use "but for" causation as a sufficient basis to determine legal consequences. *O'Gilvie*, 519 U.S. at 79. As Chief Judge Posner wrote:

> . . . a finding of 'but for' causation (what philosophers call a 'necessary condition') is not a sufficient basis for imposing legal liability. If it were, then the estates of Santa Anna, Sam

> Houston, or Columbus might also be liable to Estock [Plaintiff], plus the inventor of the steel girder . . .

Movitz v. First National Bank, 1998 U.S. App. LEXIS 13379 (7th Cir. June 23, 1998). This Court has long recognized the principle that legal consequences require proximate causation in addition to "but for" causation. *See Lanasa Fruit Steamship & Importing Co. v. Universal Ins. Co.*, 302 U.S. 556 (1938).[23]

Even the Bank recognizes that the "but for" causation test is inapplicable and that proximate cause is the proper test. The Bank does so by conceding,

> . . . that the argument that pre-petition equity holders enjoy their post-petition interest 'on account of' their prior interest loses much of its force when an open auction is held and pre-petition equity holders prevail over all other bidders . . .

(Pet. Br. at 11, n.6.) That concession is fatal. Such an auction does not remove prior ownership as a link in the chain of "but for" causation, since equity holders' status as pre-petition owners is what would entitle them, as "parties in interest," to receive notice of the auction at

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[23] *See*, Prosser and Keeton, *The Law of Torts*, § 41 at p. 264 (5th Ed. 1984) ("As a practical matter, legal responsibility must be limited to those causes which are so closely connected with the result and of such significance that the law is justified in imposing liability.") The dissent below asserts that the majority reads Section 1129(b)(2)(B)(ii) as if the word "solely" appeared in front of "on account of," but the majority's interpretation of that phrase follows directly from this Court's construction of the same phrase in *O'Gilvie*.

which they might become the winner.[24] Like Senate confirmation of a Presidential appointee to this Court, an auction would be only one of a series of causes. But, the Bank suggests that the auction is the only cause (i.e., the most direct cause) to which the bankruptcy court should attach legal consequences.[25]

Of course, if proximate cause is the proper test, the proximate cause of an event is a question of fact. As the Ninth Circuit stated in *Bonner Mall*,

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[24] Section 1109 defines, "party in interest," to include equity interest holders. Bankruptcy Rule 2002(d)(6) entitles them to notice of a plan confirmation hearing.

[25] In the same footnote, the Bank itself acknowledges that there is no authority in the Code for the bankruptcy court to hold such an auction. The Bank goes on to argue that, because no auction was held or proposed in this case, the question is not before the Court. The Bank does not explain what an auction could have accomplished in this case, where no one other than old equity holders facing the tax consequences of foreclosure would have been a prospective bidder under the terms of the Plan proposed in this case. Use of an auction in this case to determine the adequacy of the new value paid would have been as effective as a horse race would be to determine which horse is the fastest in a one-horse town. Moreover, the Court in *BFP v. Resolution Trust Corp.* 511 U.S. 531, 537-538 (1994) observed that the price obtained at a public auction sale or a sale forced by the necessities of the owner is the "antithesis" of market value. The National Bankruptcy Review Commission considered and rejected the equity auction concept proposed by the Bank. Instead, the Commission advocates automatic termination of a debtor's exclusive right to file a plan when the debtor proposes a new value cramdown plan. *National Bankruptcy Review Commission Final Report* at 562-564 (October 20, 1997). *See also, In re Moonraker Associates, Ltd.*, 200 B.R. 950, 955 (Bankr. N.D. Ga. 1996) (discussing the myriad of problems posed by an equity auction).

> . . . whether a particular plan gives old equity a property interest 'on account of' its old ownership interests in violation of the absolute priority rule or for another, permissible reason is a *factual question*.

2 F.3d at 911 (emphasis added).

> In this case, the Bankruptcy Court recognized:
> The question is whether this retention of ownership of the debtor is 'on account' of the interests that the partners had at the outset of the case, or whether the retention of ownership is on account of the new capital contributions that the plan requires partners to make.

(Pet. App at 136a.) The Bankruptcy Court then held: "[t]he contribution is easily the equivalent of the interests retained by the debtor's partners." (Pet. App. at 139a.) That factual finding cannot be disturbed unless it is "clearly erroneous." Bankruptcy Rule 8013. Moreover, that factual issue is not before the Court.

Consequently, the interests which contributing partners retained under the Plan were "on account of" their contribution of new capital.

B. The only *property* which Investors received or retained *under the Plan* was the equity interest they purchased with $6.125 million of new value.

In order to skirt the obvious conclusion that the only property obtained by equity holders under the plan is that which they purchased with new value, the Bank and its amici have hypothesized a form of "property" which the Seventh Circuit Court of Appeals labeled "highly conceptualistic". In essence, the Bank contends that the "property" which equity holders received under the plan is the "right" to purchase equity in the reorganized

debtor, and that no one else had the opportunity to purchase equity in the reorganized debtor. (Pet. Br. at 20-23.) The Bank's conceptualization, however, is fanciful, because it ignores two crucial realities: First, that equity holders who agreed to contribute new value were locked into their contributions before the plan was confirmed; and second, that all parties, including the Bank, were free to find more generous buyers for equity interests in the reorganized debtor among an unlimited universe of potential investors.

The Bank and its amici reach their conclusion that the Plan violates the absolute priority rule only by ignoring important language in Section 1129(b)(2)(B)(ii) and by cleverly manipulating the question presented to create the illusion that the *Plan* in this case granted old equity an exclusive opportunity to purchase Reorganized LaSalle. The Bank disregards the rule that each word of the statutory provision at issue must be given operative effect. *United States v. Nordic Village, Inc.*, 503 U.S. 30, 36 (1992); *Pennsylvania Dept. of Public Welfare v. Davenport*, 495 U.S. 552, 562 (1990).

> Section 1129(b)(2)(B)(ii) provides:
> the holder of any claim or interest that is junior to the claims of such class *will not* receive or retain *under the plan* on account of such junior claim or interest any property.

(emphasis added) The italicized language must be given meaning. The language is prospective: "*will* not receive or retain under the plan." A plan is not binding on anyone until after it is confirmed by the bankruptcy court. Section 1141. Logically, therefore, no property can possibly be received or retained by old equity holders "under the plan" until *after* confirmation of the plan.

In this case, prior to the confirmation hearing, the purchase money for the equity in Reorganized LaSalle

was deposited in escrow to be returned to the Investors only if the plan was not confirmed. Appellee's Designation of Additional Items to be Included in the Record on Appeal, Item 9. Accordingly, when the Plan became effective, that money, which was deposited by the Investors who had responded to the capital call, was beyond their reach. Thus, the Bank's statement that:

> . . . the plan of reorganization gave the debtor's pre-bankruptcy equity holders the *exclusive* right to retain their ownership interests in the debtor if they contributed new capital . . .

(Pet. Br. at 6. (italics in original).) is factually incorrect. In fact, the new value had already been contributed before the Plan became effective. The sale of Reorganized LaSalle's equity to the Investors occurred simultaneously with the Plan becoming effective. The Investors had no discretion or ability to back out.[26] Thus, in this case, the pre-petition partners did not receive an opportunity to purchase equity "under the plan."

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[26] In *Consolidated Rock Prods. Co. v. DuBois*, pursuant to the confirmed plan of reorganization, warrants for the future purchase of the reorganized company's stock were issued to pre-petition shareholders in exchange for their old equity. The Court stated:

> It should be noted as respects the warrants issued to the old common stockholders that they admittedly have no equity in the enterprise. Accordingly, it should have been shown that there was a necessity of seeking new money from them and that the participation accorded to them was not more than reasonably equivalent to their contribution.

312 U.S. 510, 529 n.27 (1941). Since no consideration was paid in exchange for the future investment opportunity represented by the warrants, the Court properly struck the plan down. But, that is not this case.

The most obvious "property" received or retained by the holders of old equity in this case, and the only property which they received or retained "under the [confirmed] Plan," is the equity which the Investors purchased in exchange for $6.125 million of new value. But, the Bank would have the Court ignore the actual property that Investors did get under the Plan. Instead, the Bank tries to make something out of the supposed exclusive right to purchase an interest in Reorganized LaSalle.

As a diversionary tactic, the Bank argues:

> Backers of a new value exception shift the focus from the property interest at issue – the exclusive opportunity to obtain an equity stake in the reorganized debtor – to the ownership interest ultimately purchased as a result of exercising that property right. But when the interpretive focus is *not* on the purchased equity interest, but instead, as the statute requires, is on the property interest provided by the plan (the *exclusive right* to share in ownership of the debtor), the conclusion is inescapable that the pre-bankruptcy equity holders are receiving property 'on account of' their pre-bankruptcy interests.

(Pet. Br. at 19-20.)[27]

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[27] The Bank (Pet. Br. at 20) misrepresents *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207-209 (1988) as a "square *holding*" that the opportunity to participate in the reorganization is itself property. *Ahlers* had nothing to do with the opportunity to participate in a reorganization. That case held that retention of even a worthless equity interest, under a plan, is "property," under Section 1129(b)(2)(B)(ii). An accurate statement of the Court's holding is: " . . . we think that the interest respondents would retain *under any reorganization* must be considered 'property' under § 1129(b)(2)(B)(ii) and therefore

There is a fatal problem with the Bank's argument. The so called "exclusive opportunity to obtain an equity stake in the reorganized debtor" never existed in this case. It is pure fiction, resourcefully invented by opponents of new value plans to avoid the impact of more than eighty-five years of precedent supporting the exchange of interests in reorganized entities for necessary new value. That the so-called "exclusive opportunity" did not exist is demonstrated by reviewing the process leading toward confirmation of a plan of reorganization by a bankruptcy court.

Section 1121 is entitled: "Who may file a plan." That section provides, in essence, that only the debtor may file a plan for the first 120 days of the case and that the bankruptcy court may reduce or increase that exclusive period "for cause" at the request of a party in interest.[28] To be sure, Congress understood and intended that the "exclusive period" provided by Section 1121 would give some leverage to a debtor in the plan bargaining process.[29] Accordingly, the Bank and its amici, representing only the interests of secured creditors, lobbied heavily

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can only be retained *pursuant to a plan. . . . " Ahlers*, 485 U.S. at 209 (emphasis added).

[28] In this case the Respondent partnership entity, and not its pre-petition partners, was the debtor, with the exclusive right to file a plan. Therefore, the pre-petition partners never had any right, exclusive or otherwise, to file a plan. Before confirmation, the Bank filed a motion in the bankruptcy court seeking to terminate the Debtor's exclusive right to file a plan and sought leave to file its own plan. That motion was denied and the Bank did not appeal.

[29] H.R.Rep. No. 595, 95th Cong., 2nd Sess. (1978) p6191.

against debtor exclusivity when Congress was considering the Code.[30] Not content with the progress they have made in Congress toward amending the Code, they seek to have the Court legislate a significant limitation on a debtor's right under Section 1121.

A debtor's exclusive right to file a plan is nothing more than the right to make the first offer to creditors and interest holders for a proposed restructuring of the debtor entity. No legal rights are created by the offer itself. The mere pendency of an unaccepted offer cannot create "property," i.e., the "opportunity to obtain an equity stake" that the Bank and its allies condemn. If no class of creditors accepts the offer, the offer dies on the vine. Even after the offer of the debtor's proposed plan is accepted by an impaired class of creditors, neither old equity nor any other party in interest has yet received "property."[31] If, and only if, the plan is accepted by at least one class of creditors and confirmed by the bankruptcy court, does the prospective investor's offer become "property."

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[30] That lobbying continues. In response to the secured creditors' lobby, Congress amended Section 362 in 1994 to provide for reduction of the debtor's exclusive period from 120 to 90 days in a "single asset real estate case" [defined by Section 101(51)(B)]. Section 362(d)(3). Creditor lobbying has also resulted in a proposal by The National Bankruptcy Review Commission to amend the Code to provide that the debtor's exclusive period will terminate automatically if the debtor moves to confirm a non-consensual new value cramdown plan under which unsecured creditors will not be paid in full. *National Bankruptcy Review Commission Final Report* (Oct. 20, 1997), Recommendation 2.4.15 at page 457.

[31] The plan must be submitted to the bankruptcy court for a hearing on confirmation.

A plan is not binding upon anyone until after it is confirmed by an order of the bankruptcy court. Section 1141. No one can possibly receive or retain any "property," "under the plan" or otherwise, until *after* the court confirms the plan. In this case, where *prior to confirmation* the new value contribution was already deposited in escrow, beyond the reach of the Investors, old equity *never* had any enforceable option to purchase Reorganized LaSalle's equity. The "exclusive opportunity to obtain an equity stake," championed by the Bank, is a chimera.

A proposed plan *must* provide adequate means for the plan's implementation, such as an investor to fund the plan. Section 1123(a)(5)(J). Congress placed no limitation on the sources from which a plan proponent could seek new capital.

Chapter 11 clearly contemplates competition between plans seeking creditors' acceptance and court confirmation, not competition between potential investors seeking to invest in the same plan.[32] That is evidenced by Section

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[32] An equity auction plan, as suggested by the Bank is unworkable. Because plans are tailored to the particular needs of the investors who propose to fund them, it is unreasonable to presume that a competing investor would want to be bound to the terms of a competitor's plan. It is also unreasonable to believe that a bankruptcy court would find an equity auction plan feasible under Section 1129(a)(11) without evidence that the auction would successfully raise sufficient funds to consummate the plan and provide working capital to the reorganized entity. Such an auction would have been futile in this case where no one other than existing partners would have any incentive to invest. Finally, an auction is unlikely to reflect market value in those cases in which some bidders, such as the Bank in the instant case, are entitled to receive a portion of the proceeds of the auction. That is true, because other bidders will

1121(d), which permits creditors to request termination of the debtor's exclusive period so that another plan can be proposed, and by Section 1129(c), which requires the court to confirm only one plan among competing plans which have been accepted by creditors.

One who agrees to fund a proposed plan is supplying inducement for competing free riding plans. Creditors can "shop" that plan with the possibility that another more generous plan might be proposed and confirmed. It is ludicrous to suggest that one who has made the opening offer to fund an unconfirmed plan has received property under the confirmed plan. In recognition of the fact that the first offeror does not acquire any property until closing of the contemplated transaction, courts frequently approve a "breakup fee" as compensation for supplying the first offer.[33]

II. The New Value Corollary has been an established part of reorganization practice since 1869.

For the reasons set forth above, the Plan satisfied the plain language of Section 1129(b)(2)(B)(ii). The alternative readings suggested by the Bank and its amici are incorrect. If, however, the Court concludes that the language of Section 1129(b)(2)(B)(ii) has more than one plausible

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be reluctant to bid, knowing that their bids can be surpassed by what is in effect the bid of a shill.

[33] Courts have long-recognized that breakup fees may be required to encourage the making of a first offer, since that offer will be shopped around to attract higher offers. *See, e.g., In re Integrated Resources, Inc.*, 135 B.R. 746, 750 (Bankr. S.D.N.Y.), *aff'd*, 147 B.R. 650 (S.D.N.Y. 1992), *appeal dismissed on jurisdictional grounds*, 3 F.3d 49 (2nd Cir. 1993). Courts often erroneously describe an entity making a first offer as a "stalking horse."

meaning (e.g., because the Bank and its amici disagree about the consequences of the meaning of "on account of,"), then consideration of pre-Code practice and legislative history is appropriate to interpret that language. *Dewsnup v. Timm*, 502 U.S. 410 (1992).

Key to understanding the new value corollary is recognizing that the corollary is simply a restatement of the absolute priority rule itself in positive, rather than negative, terms.[34] The right to sell equity in a reorganized entity to pre-petition owners only for a price which is reasonably equivalent to the value received is the flip side of the prohibition against selling that equity for less

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[34] As stated at 7 *Collier on Bankruptcy* ¶1129.04[4][c][i][B] at 1129-109-111 (15th ed. rev. 1998):

> . . . application of *Case's* dicta [the new value corollary] yields the same result in all cases as does the absolute priority rule to the same facts. For all practical purposes, the two are equivalent.
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> . . . .
>
> The interplay of these relationships means that any contribution of money or money's worth permits owners to retain ownership so long as creditors receive property equal to the debtor's reorganization value. This result obtains, regardless of whether the inquiry starts with the absolute priority rule or *Case's dicta*.

See also, In re Bonner Mall Partnership, 2 F.3d 899, 906 (9th Cir. 1993) *cert. dismissed*, 513 U.S. 18 (1994).

Just as the principle that a debtor may transfer its property for a fair equivalent value is inherent in the prohibition of Section 548(a)(2) against a debtor transferring property for less than a fair equivalent value, so too the new value corollary is inherent in Section 1129(b)(2)(B)(ii). An explicit statement of the corollary in Section 1129(b) would have been a redundancy and would have increased the statutory complexity which the drafters of that Section expressly sought to avoid.

than that price. Indeed, the corollary was recognized by the Court, even before the Court in *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S. 106 (1939) chose the "absolute priority" doctrine over its competition, the "relative priority" doctrine. The nature of the new value principle as a corollary of the absolute priority rule is illuminated by viewing the absolute priority rule in historical context.

The absolute priority rule originated from the application of fraudulent transfer law to railroad reorganizations accomplished through the vehicle of federal equity receiverships, long before there was any federal reorganization statute.[35] *In re Snyder*, 967 F.2d 1126, 1128 n. 1 (7th Cir. 1992). Unsecured creditors, who were squeezed out in such reorganizations by alliances between secured bondholders and shareholders, attacked those reorganizations as fraudulent transfers intended to hinder, delay and defraud unsecured creditors. The Court sustained such attacks as early as 1869. In *Chicago Rock Island & Pac. R.R. v. Howard*, 74 U.S.(7 Wall) 392 (1869), the Court held that the sale proceeds of an insolvent railroad's assets in the hands of its shareholders were charged with a trust for the benefit of unpaid unsecured creditors. The Court held that: " . . . any one receiving any portion of the fund by voluntary transfer, or *without consideration*, may be compelled to account. . . . " *Howard*, 74 U.S. at 411 (emphasis added). The corollary to that holding is that if shareholders paid fair consideration to the creditors in exchange for what the shareholders received, no trust would have resulted.

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[35] *See*, B. Markell, *Owners, Auctions and Absolute Priority in Bankruptcy Reorganizations*, 44 Stan. L. Rev. 69, 74-90 (1991) for an excellent review of the origins and current status of the absolute priority rule.

In 1913 the Court in *Northern Pac. Ry. v. Boyd*, struck down any arrangement by which subordinate rights of shareholders are secured *at the expense of unpaid unsecured creditors*, but also observed that old equity could participate over the objection of an unsecured creditor by making a "fair offer." 228 U.S. 482, 508 (1913). In other words, in *Boyd* the Court reaffirmed its *Howard* holding that creditors are entitled to priority over shareholders, *and* its corollary that "fair offers" by old equity are not at creditor expense. Subsequently, the Court in *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, made it clear that "fair offers" had to be in "money or money's worth." 271 U.S. 445 (1926).

In 1933 and 1934, Sections 77 and 77B respectively, the first reorganization statutes, were added to the Bankruptcy Act of 1898 (the "Act").[36] As finally amended, those sections required, as a condition for confirmation, that proposed plans be found by the court to be "fair and equitable."[37] That statutory language was carried forward without alteration into Chapter X of the Act and finally to Section 1129(b)(1) of the Code.[38]

There is substantial authority demonstrating that courts and commentators recognized that a plan of reorganization utilizing the new value corollary was "fair and equitable." Much of this authority preceded the Court's decision in *Case v. Los Angeles Lumber Prods. Co.*, 308 U.S.

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[36] Act of July 1, 1898, Pub.L. 55-171, 30 Stat. 544 (1898) (repealed 1979). See Amicus Brief of Professor Bruce A. Markell for the history of the term "fair and equitable."

[37] That requirement was applicable, irrespective of creditor consent to a plan.

[38] 11 U.S.C. § 621(2) (1970) (Repealed); *Marine Harbor Properties, Inc. v. Manufacturer's Trust Company*, 317 U.S. 78, 85-87 (1942).

106 (1939). Clearly, therefore, the new value corollary was not "invented" by dicta in *Case*. Rather, *Case* properly discussed the new value corollary as black-letter law. In addition to the holding of the Court in *Kansas City Terminal* (a holding on which the Court explicitly relied in *Case*, when the Court later specified the components of the new value corollary), the new value principle was applied to approve reorganizations in several reported pre-Code decisions: *Kansas City Terminal Ry. Co. v. Central Union Trust Co.*, 28 F.2d 177 (8th Cir. 1928) (after remand from the Supreme Court); *Jameson v. Guaranty Trust Co. of New York*, 20 F.2d 808 (7th Cir. 1927); *Palmer v. Banker's Trust Co.*, 12 F.2d 747 (8th Cir. 1926); *Oehring v. Fox Typewriter Co.*, 272 F. 833 (6th Cir. 1921); *Keech v. Stowe-Fuller Co.*, 205 F. 887 (6th Cir. 1913). *See also*, Swaine, *Reorganization of Corporations; Certain Developments in the Last Decade*, 27 Colum. L. Rev. 901, 914 n. 47 (1927).

Following the Court's decision in *Case*, which specified the components of the new value corollary, the Court applied the new value principle in *Mason v. Paradise Irrigation Dist.*, 326 U.S. 536, 541-42 (1946) ("It has long been recognized in reorganization law that those who put new money into the distressed enterprise may be given a participation in the reorganization plan reasonably equivalent to their contribution."), and the principle was recognized in *Consolidated Rock Products Co. v. DuBois*, 312 U.S. 510, 529 n. 27 (1940); *Marine Harbor Properties v. Manufacturer's Trust Co.*, 317 U.S. 78, 85 (1942); and *General Stores Corporation v. Shlensky*, 350 U.S. 462, 466 (1956) ("Readjustment of all or part of debts of an insolvent company without sacrifice by stockholders may violate the fundamental principle of a fair and equitable plan. . . . ").[39]

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[39] The *Mason* case involved a reorganization under Chapter IX of the Bankruptcy Act. The Court confirmed the plan over a

Subsequent to *Case*, numerous pre-Code lower court decisions recognized that the new value principle was part of the absolute priority rule.[40] Furthermore, the leading bankruptcy treatise, 6A *Collier on Bankruptcy*, ¶11.06 at 228-231 (14th ed. 1977), recognized the new value corollary as black-letter law. Until *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 203 n. 3 (1986), in which the Court, at the urging of the Solicitor General, first questioned the corollary's continued existence under the Code, courts assumed that the new value corollary was alive and well under the Code. *See In re U.S. Truck Co.*, 800 F.2d 581 (6th Cir. 1986); *In re Potter Material Service, Inc.*, 781 F.2d 99 (7th Cir. 1986).

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dissenting unsecured creditor's objection that the party contributing new capital received improper preferential treatment. The Court reaffirmed and applied its ruling in *Case* and held that a party contributing new capital, "may be given a participation in the plan reasonably equivalent to their contribution." *Mason*, 326 U.S. at 541-42. While the contributing party in *Mason* was a creditor rather than an equity holder, the holding in *Mason*, together with the Court's citation to *Case*, clearly demonstrates the Court's understanding of the new value corollary as a principle of general application, regardless of whether an equity holder or a creditor makes the contribution. Indeed, it is clear from the reference in Section 1129(b)(2)(B)(ii) to a "junior claim" that the new value corollary would permit a class of subordinated creditors to cramdown a new value plan on a dissenting class of senior unsecured creditors.

[40] *See, e.g., In re Muskegon Motor Specialties*, 366 F.2d 522 (6th Cir. 1966) (there is no room in new corporation for shareholders of insolvent debtor unless they contribute fresh capital); *See also, In re American Trailer Rentals Company*, 325 F.2d 47 (10th Cir. 1963); *Spitzer v. Stichman*, 278 F.2d 402 (2d Cir. 1960); *In re Universal Lubricating Sys.*, 71 F. Supp. 775 (W.D. Pa. 1947).

In the amicus brief which the Solicitor General, Robert H. Jackson, filed jointly with the Securities and Exchange Commission ("SEC") in *Case*, the Solicitor General brought to the Court's attention:

> the *recognized corollary* of the absolute priority doctrine – the rule that junior interests for whom no equity remains may nevertheless be allowed to participate if they are willing to contribute necessary money or money's worth to the reorganized company.

Brief at 14-15 (emphasis added).[41]

In *Case*, the Court specifically adopted the Solicitor General's position on the elements of the new value corollary, and on the relationship of that corollary to the absolute priority rule. Markell, *supra* note 35 at 91.[42]

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[41] The Bank contends that, " . . . the 'corollary' terminology can be seen as historically inaccurate." Pet. Br. n. 1 at 4. But, Solicitor General Jackson used that term in the brief he filed in 1939. Apparently, the first time the term "exception" was used, was in *Ahlers*.

The SEC also recognized the existence and validity of the new value principle, and its character as part and parcel of the absolute priority rule, in its comprehensive report on protective and reorganization committees. *Securities and Exchange Comm'n. Rep. on the Study and Investigation of the Work, Activities, Personnel and Functions of Protective and Reorganization Committees*, pt. 8 at 143 (1940). The SEC cited with approval numerous cases recognizing that the absolute priority rule permitted pre-petition owners to retain an interest in reorganized companies in exchange for paying fair value in cash or property. *Id.* at 144-147.

[42] The absence of a reported case under Chapter X involving application of the new value corollary, reinforces the conclusion that the corollary is "black-letter law." The existence of well-settled legal principles rarely result in reported decisions. Furthermore, small non-public companies, which

Considering the fact that it was Solicitor General Jackson's brief which induced the Court to state its *Case dicta*, it is disappointing to see Jackson's representation to the Court that there was a "recognized corollary to the absolute priority doctrine" dismissed by the current Solicitor General with the unsupported statement: "Our subsequent research has shown that suggestion not to be a correct reflection of the law at that time." (SG Br. at 24, n. 25.)[43] With all due respect, it appears that the Solicitor General's office committed itself to a position in *Ahlers*, and is now simply unwilling to reconsider that position, even though it is unable to cite any evidence justifying its abandonment of Solicitor General Jackson's position.

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would be the likeliest candidates for new value plans, being ineligible to file under Chapter X, sought relief under Chapter XI. The fair and equitable requirement was eliminated from Chapter XI in 1952, thereby eliminating any possibility of the new value corollary becoming an issue in those cases. Pub. L. No. 82-456 § 35, 66 Stat. 420, 433 (1952). Furthermore, Chapter X's provision mandating the appointment of trustees caused many larger companies that would have qualified under Chapter X to seek relief under Chapter XI. Markell, *supra* note 35 at 92; 7 *Collier on Bankruptcy* ¶1129.04[4][c] at 1129-106-107 (15th ed. rev. 1998).

[43] In the same footnote, the Solicitor General further attempts to sidestep Jackson's brief on the ground that whatever may have been the law in 1939, in subsequent filings he has consistently taken the position he takes in this case. However, he does *not* point out that during the 59 years which elapsed between *Case* and *Ahlers*, the Solicitor General made no filings on this issue.

III. When Congress enacted the Code, it understood that the New Value Corollary was an established part of reorganization practice and of the absolute priority rule.

Congress was well aware of the *Case dicta* as it considered the legislation that became the Code. That is beyond debate, because Congress considered and rejected a proposal by the Bankruptcy Commission to modify the *Case dicta* by removing its requirement that the new contribution be in cash. Congress explicitly rejected proposals in Section 7-303(4) of the 1973 Bankruptcy Review Commission's Bill (H.R. 31, 94th Cong.) and Section 7-301(4) of the Judges' Bill (H.R. 32 94th Cong.) to expand the new value principle by recognizing the non-monetary contributions prohibited by *Case*. In commenting on those proposals, counsel to the Subcommittee on Civil and Constitutional Rights of the House Judiciary Committee wrote:

> The 'future contribution' doctrine sharply departs from the absolute priority rule of § 221(2) of the Bankruptcy Act. The Supreme Court decision in *Case v. Los Angeles Lumber Products Co.*, 306 U.S. 106 (1939) is overruled. The proposal follows the district court opinion in that case.

See Bankruptcy Act Revision, Hearings before the Subcommittee on Constitutional and Civil Rights of the House Committee on the Judiciary on H.R. 31 and 32, 94th Cong., 1st and 2d Sess., Ser. 27, App. 248 (1976). This commentary makes it abundantly clear that Congress understood the new value principle to be part of (i.e. a

corollary of) the absolute priority rule codified in the "fair and equitable" requirement of Chapter X, and intended to make no change to that "black-letter" principle when it carried the "fair and equitable" requirement forward into the Chapter 11 of the Code.[44]

The Court also understood that the *Case dicta* was part of the absolute priority rule when it observed:

> When considering adoption of the current Code, Congress received a proposal by the Bankruptcy Commission to modify the *absolute priority rule* to permit equity-holders to participate in a reorganized enterprise based on their contribution of 'continued management . . . essential to the business' or other participation beyond 'money or money's worth.'

Norwest Bank Worthington v. Ahlers, 485 U.S. 197, 205 (1988) (emphasis added).

IV. Variances between the Bankruptcy Act and the Code have no effect on the meaning of "fair and equitable."

To be sure, Congress reformed the Bankruptcy Act of 1898 and made changes in reorganization law when it enacted the Code. Many of those changes were designed

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[44] All of the commentary and discussion on the new value principle cited by the Solicitor General (SG Br. 18-21) reflects criticism of provisions, such as those contained in H.R. 31 and H.R. 32, which either: a) expanded the new value principle to include non-cash contributions, or b) permitted participation by equity holders five years after confirmation if such participation was justified by the financial condition of the reorganized enterprise at that time. This legislative history reinforces the conclusion that Congress intended no change to the new value corollary and carried the new value corollary forward, without alteration, into the Code as part of the requirement that a plan be "fair and equitable."

to remove the delay and inflexibility which caused financially troubled companies to shun Chapter X and, instead, seek relief under Ch XI. 7 *Collier on Bankruptcy*, ¶1129.04[4][c][1][A] at 1129-106 (15th ed. rev. 1998) However, the Code made no change whatsoever in the *substance* of the rule that a court must confirm a reorganization plan over the dissent of unpaid unsecured creditors when the plan is "fair and equitable" with respect to those creditors. Nor did Congress make any change in the "fixed principle" of *Boyd* when it codified that principle, together with the new value corollary, in Section 1129(b)(2)(B)(ii).

The Bank and its amici attempt to make much of the unremarkable point that Congress relaxed the absolute priority rule by allowing the majority within an impaired creditor class to waive the absolute priority rule. (Pet. Br. at 27 n. 15.) This argument, however, simply misses the point. By requiring a dissenting *class, rather than an individual creditor* to invoke the absolute priority rule, the Code merely changed the identity of the party who possessed standing to invoke the absolute priority rule. This change in standing had no effect on the substance of either the absolute priority rule or its new value corollary. Regardless of whether a single creditor, as under Chapter X, or a class, as under Chapter 11, invokes that rule by voting to reject a plan, *the standard for confirming a plan over the dissenting vote, that a plan be "fair and equitable," is the same under the Code as it was under the Act.*[45] Thus, even

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[45] Thus, whether the plan in *Case* would have been confirmed under Chapter 11 is not relevant. (Pet. Br. at 37.) The absolute priority rule focuses on those who dissent, not on those who accept a plan. The *standard* which the Court applies in determining whether to confirm a plan over a dissent is the same under Section 1129(b) as it was in *Kansas City Terminal* and *Case*.

if circumstantial evidence of Congressional intent were sufficient to alter the well recognized meaning which the phrase "fair and equitable" acquired before 1978, no evidence of such intent has been submitted to this Court.[46]

V. The New Value Corollary is consistent with Bankruptcy Code policies.

A. The new value plan in this case maximized value for *all* creditors.

The purpose of Chapter 11 reorganization is to maximize value for creditors. *Toibb v. Radloff*, 501 U.S. 157, 163 (1991). The Plan in this case successfully met the objectives of Chapter 11.[47] *See United States v. Whiting Pools, Inc.*, 462 U.S. 198, 203 (1983) ("Congress presumed that the assets of the debtor would be more valuable if used in a rehabilitated business than if 'sold for scrap.' "); *Associates Commercial Corp. v. Rash*, 520 U.S. 953 (1997) (recognizing that going concern value may exceed liquidation value). The going-concern premium in this case was the

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[46] This case is materially different from *Union Bank v. Wolas*, 502 U.S. 151 (1991), where the Court found that Congress had made a *substantive change* in preference law by eliminating the substantive requirement of proof that the defendant had reasonable cause to believe that the debtor was insolvent when it made an alleged preferential transfer. See also: *United Savings v. Timbers of Inwood Forest*, 484 U.S. 365, 380 (1988) ("Such a major change in the existing rules [Code] would not likely have been made without specific provision in the text . . . it is most improbable that it would have been made without even any mention in the legislative history.").

[47] The bankruptcy court recognized that the Plan fulfilled the objectives of Chapter 11 when it made a factual finding that the plan proponents acted in good faith in filing the Plan. That finding was affirmed on appeal. Pet. App. 143a-145a; 28a-29a.

Investors' $6.125 million of new capital. In addition, by waiving their right to distributions on account of an aggregate of $7.7 million of allowed unsecured claims held by them, the Debtor's general partner and an affiliate effectively injected an additional $3 million of working capital into Reorganized LaSalle. (Pet. App. at 128a-130a, 139a n. 5.) That premium would not have been available in a foreclosure or Chapter 7 case. The reorganization enabled unsecured trade creditors who had originally bargained for recourse against the Debtor, as contrasted with the Bank who did not, to be paid in full. That proposed treatment induced those trade creditors to accept the Plan.

The Bank also shared in and benefitted from the premium. As a result of having contractually agreed at the time it made its loan to the Debtor to look only to the real estate, and to waive recourse against any other property of the Debtor, the Bank would have had no unsecured claim outside of Chapter 11. But, Section 1111(b), an innovation of the Code, provides that nonrecourse secured creditors, such as the Bank, who are undersecured, must be treated in Chapter 11 as if they had recourse.[48] In addition to giving the Bank the full

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[48] That provision, along with the new Code Section 1111(b)(2), which permits undersecured creditors to elect not to have their claim bifurcated as required by Section 506(a), but to treat the entire claim as a secured claim, was designed to protect a lender against undervaluation of its collateral in connection with a cramdown. "Prior to adoption of the Bankruptcy Code, there were many Chapter XII cases [under the Act] which dramatized the valuation risk associated with the cramdown power." 7 *Collier on Bankruptcy* ¶1111.03[1][a][iii][A] at 1111-20 (15th Ed. rev. 1998). It is ironic that the Bank, which complains about valuation, never availed itself of the protection which Section 1111(b)(2) was expressly designed to provide.

present value of its secured claim, the Plan provides the Bank's unsecured deficiency claim with a distribution on account of that claim of at least $19 million, which at the time of confirmation of the Plan, had a minimum present value in excess of $6 million. The Plan's minimum $19 million distribution to the Bank on account of its artificially created deficiency claim represents a huge windfall.[49] The facts belie the Bank's contention that it was "short changed." (Pet. Br. at 8.)

If, as advocated by the Bank, an undersecured creditor can block a plan of reorganization which has been accepted by other creditors, because the plan is to be funded by pre-petition equity holders, an undersecured creditor will have greater rights than an oversecured creditor. This will incentivize marginally secured creditors to undervalue their collateral and thus take control of a reorganization.

We are compelled to reply to the hyperbolic prediction of the Bank's amici, the American College of Real Estate Lawyers, that the decision below, "not only threatens existing mortgage debt held by lenders, but also threatens the future of the real estate and real estate securities industry." (ACREL Br. at 23-24.) Although *In re*

Therefore, it is disingenuous for the Bank to state that it was "*left* with an unsecured deficiency claim of $38.5 million," when it elected to be treated as an unsecured creditor. (Pet. Br. at 5-6 (emphasis added).)

[49] Had it made the Section 1111(b)(2) election, the Bank would have had only a $93 million secured claim, and no artificially created unsecured deficiency. To further its goal of foreclosing, the Bank chose not to make the Section 1111(b)(2) election. Absent that deficiency claim, the Bank would have lacked standing, as an unsecured creditor, to object that the Plan violated Section 1129(b)(2)(B)(ii).

Bonner Mall Partnership, 2 F.3d 899 (9th Cir. 1993) has been on the books for some time, the real estate industry has had the greatest boom since the Depression.

B. The New Value Corollary does not improperly deprive creditors of "control".

The task of determining who has control of a Chapter 11 case begins where all such inquiries must begin: with the language of the statute itself. Even a cursory examination of the Code reveals the misleading nature of the catch-phrases used by the Bank to describe the supposed evil – loss of creditor control – resulting from the new value corollary. (Pet. Br. at 41.) The Code prescribes which, if any, of the parties in interest in a Chapter 11 case has control of each step of the reorganization process.[50] The Code also spells out the role of the bankruptcy court under Chapter 11.

The Bank's policy arguments against the new value corollary ignore the mandate of Section 1129(b)(1). Those arguments read out of the Code a bankruptcy judge's statutory obligation to confirm a plan over the rejection of a dissenting unsecured creditor class which the bankruptcy court finds to have been treated "fairly and equitably".[51] Reduced to their true essence, the Bank's policy

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[50] *United Savings v. Timbers of Inwood Forest*, 484 U.S. 365, 378 (1988) ("The debtor in process of reorganization . . . is given many temporary protections against the normal operation of the law.").

[51] For at least eighty-five years, this Court has recognized that a creditor who has received a fair offer is estopped from contesting its treatment under a plan which allows for participation by a debtor's equity holders. *Northern Pac. Ry. v. Boyd*, 228 U.S. 482 (1913); *Kansas City Terminal Ry. v. Central*

arguments against the new value corollary would have this Court rule that: (1) an *undersecured* creditor, and not the bankruptcy judge, should become the arbiter of disagreements between classes, and (2) such a creditor has an *absolute right* to veto any plan which is not to its liking, even if the plan satisfies the legal standard which this Court prescribed in the *Kansas City Terminal* case and repeatedly reaffirmed. The Bank urges this Court to disregard the plain language of Section 1129(b), and to overrule that long-standing precedent, because of the Bank's desire for total control of the reorganization process. Although the Bank has standing in this Court solely on the basis of its artificially created *unsecured* deficiency claim, the Bank complains that: "The new value plan here prevents the bank from foreclosing. . . . "[52] (Pet. Br. at 42.) The Bank suggests no principled basis (other than its desire to foreclose and wipe out other creditors) why its vote against the Plan should take precedence over the trade creditors' vote in favor of the Plan.[53]

The Bank suggests that the new value corollary promotes "judicial second-guessing" of creditors' business judgement which is "contrary to fundamental bankruptcy

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Union Trust Co., 271 U.S. 445 (1926). The Solicitor General would, instead, give a dissenting class of creditors the right to veto a plan which treated it "fairly and equitably" within the meaning of those cases.

[52] The Bank had no right to foreclose because the Property was necessary to an effective reorganization that was in prospect. *United Savings v. Timbers of Inwood Forest*, 484 U.S. 365, 375-376 (1988).

[53] One can only speculate what position the Bank would take in cases where the numbers were reversed, and a class of recourse unsecured creditors holding large claims opposed a plan which the Bank, holding a small undersecured deficiency claim, supported.

policy." (Pet. Br. at 48, n. 27.) In support of this patently incorrect statement, the Bank quotes a portion of this Court's decision in *Norwest Bank Worthington v. Ahlers*, 485 U.S. 197, 207 (1988), but distorts the meaning of that statement by omitting the crucial words which are italicized in the following complete quotation:

> the Code provides that it is up to the creditors – and not the courts – to accept or reject a reorganization plan *which fails to provide them adequate protection or fails to honor the absolute priority rule.*

By its misquotation, the Bank represents that this Court has held that Section 1129(b) does not require bankruptcy judges to override the vote of a dissenting class which has received fair and equitable treatment. The Court did no such thing. The Court was not questioning, or even addressing, the bankruptcy court's statutory mandate in Section 1129(b)(1), to "second-guess" the decision of a dissenting class regarding a plan.

The facts of *In re U.S. Truck Co.*, 800 F.2d 581 (6th Cir. 1986), illustrate the harmful effect of a ruling in the Bank's favor. In that case, a single class consisting of one unsecured creditor, a Teamsters Committee which had a claim for damages growing out of rejection of a burdensome collective bargaining agreement, voted to reject a plan of reorganization which had been accepted by other unsecured creditors. Apparently, the Teamsters voted to reject the plan, not because the plan was unfavorable to its interests as a creditor, but because the Teamsters had a non-creditor interest in blocking rejection of collective bargaining agreements. The plan was funded by a $100,000 of new value by the Investors. The Bank's interpretation of 1129(b) would have deprived all other creditors of the benefits of the plan and allowed the Teamsters to defeat the plan, in order to establish a precedent in

negotiations with other trucking companies. Section 1129(b) should not be read to permit such a result, simply because former shareholders have facilitated a reorganization by paying fair value for the equity of the reorganized entity.

Another example of possible mischief from sustaining the Bank's position, would be a case in which a church found itself in financial difficulty, perhaps as a result of an environmental problem. Suppose that the church building had been pledged to secure a non-recourse loan for an amount far in excess of the value of that collateral. Suppose that a generous plan which paid unsecured creditors much more than they could ever get on account of their claims from a liquidation and which also provided for remediation of the environmental problem was to be funded by a substantial contribution of fresh cash from the church members. Suppose further, that the plan was accepted by the overwhelming majority of creditors, but that the holder of the relatively small separately classified non-recourse deficiency claim, relying upon the fact that he could hold the collateral hostage for the full amount of his claim, voted against the plan, even though it provided that creditor with far more cash than he would ever receive from any other source.[54] Rejecting the new value corollary would prevent confirmation of such a plan, and enable the non-recourse undersecured creditor either to blackmail other creditors into allowing him to be paid in full or to cause a liquidation in which the undersecured creditor would foreclose on the church building, unsecured creditors with recourse

[54] As set forth above, the Seventh Circuit requires that non-recourse unsecured deficiency claims be placed in a separate class. *In re Woodbrook Associates*, 19 F.3d 312, 319 (7th Cir. 1994).

would lose their reorganization premium and the church members would be wiped out. Even the Bank would have difficulty characterizing such a scenario as proper "creditor control."[55]

C. Judicial fallibility is no reason to ignore the plain language of the Code.

Much of the Bank's dissatisfaction with the new value corollary is based not on the substance of the rule, but rather, on purely hypothetical fears that bankruptcy judges will err in valuing debtor firms, and thereby permit old owners to purchase a reorganized entity's equity too cheaply. (Pet. Br. at 45.)[56]

[55] Section 1129(b)(2)(b)(ii) applies in all Chapter 11 cases, the overwhelming majority of which involve small privately held companies, whose access to capital markets is restricted. Elizabeth Warren, *The Untenable Case for Repeal of Chapter 11*, 102 Yale L.J. 437, 441 (1992).

Common sense dictates that equity holders of such entities are an important, if not the only source of reorganization capital for such debtors. Since Section 1129(b)(2)(B)(ii) also applies to Chapter 9 of the Code, which deals with the adjustment of debts of a municipality, pursuant to Section 901 of the Code, one can postulate similar fact situations where members of a water district or other "municipality," as defined in Section 101(40), would be blocked by a recalcitrant class of creditors from confirming a plan of reorganization which otherwise treated its creditors fairly and equitably, because the old members were funding the plan with a substantial contribution of fresh cash.

[56] The Bank does not argue that the contributing partners *in this case* paid too little for their interests in Reorganized LaSalle. No such argument is possible; the bankruptcy court made a factual finding that the contributing partners paid a fair price for their equity in Reorganized LaSalle. (Pet. App. at 139a.) That finding was upheld on appeal and has not been challenged here. (Pet. App. at 24a-26a.)

The Bank's argument proves too much. Independent of the Corollary, a bankruptcy judge who applies the absolute priority rule must value a debtor's business. *Consolidated Rock Products Co. v. DuBois*, 312 U.S. 510, 524 (1940). Indeed, there are a myriad of issues arising under the Code which can be resolved only by bankruptcy judge's valuation decision. *See, e.g.*, Sections 362(d)(2)(A), 506(a), 548(a)(2)(A) and 1129(b)(2)(B)(i). If the existence of legal rules depended on the infallibility of judges, no such rules would survive. Carrying the Bank's argument to its logical conclusion leads to the patently absurd result that bankruptcy judges, and indeed *all judges*, should be prohibited from ever making valuation decisions.[57] But the Bankruptcy Code cannot be administered in the absence of valuation decisions. If the Bank thinks bankruptcy judges are suddenly unfit to value property after doing so for more than one hundred years, the Bank should seek redress from Congress, not the Court.[58]

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[57] In *Associates Commercial Corporation v. Rash*, 520 U.S. 953 (1997), the Court resolved a dispute about the standard to be used by bankruptcy courts for valuing a security interest when the debtor invokes the cram down power to retain the collateral over a secured creditor's objection. The Bank's argument would render that case a nullity.

[58] A variation on the theme that bankruptcy judges are incompetent, is the Bank's suggestion that new value plans always involve allegedly improper self-dealing by insiders. This argument assumes that bankruptcy courts will invariably fail to properly assess whether old equity holders are paying a fair price for their new equity in the reorganized entity. This Court expressed no such concerns in its *Boyd, Kansas City Terminal, Case* or *DuBois* decisions.

Furthermore, the Bank is simply wrong when it states (Pet. Br. at 43) that Section 363 prohibits a debtor from selling property to its shareholders. The Code contains no such prohibition. *In re W.A. Mallory Co., Inc.*, 214 B.R. 834, 838 (Bankr. E.D. Va. 1997), the only case which the Bank cites for an assertion which is at odds with the plain language of Section 363(b), merely holds that sales to insiders are subject to a higher level of scrutiny than sales to non-insiders. *Id.* at 837. In fact, nothing in the plain language of Section 363 of the Code prohibits a debtor's transactions with insiders. The new value corollary subjects sales to equity holders to a higher level of scrutiny than funding offers from other investors by requiring contributing equity holders to pay a fair price. Notably, a plan which proposed to sell a reorganized entity's equity to a total stranger can be confirmed without any finding that the stranger paid a fair price, so long as the plan satisfies Section 1129(a)(7)(A)(ii).

The Bank suggests that valuation problems did not arise under Chapter X due to the existence of disinterested trustees. (Pet. Br. at 44.) However, the Bank does not explain why Chapter X trustees, the Securities and Exchange Commission and bankruptcy courts were any less fallible than are today's bankruptcy judges in valuing businesses, as they were required to do when applying the absolute priority rule. *DuBois*, 312 U.S. at 570.

VI. Conclusion

For all of the reasons set forth above, Respondent respectfully requests that the Court affirm the Court of Appeals.

Respectfully submitted,

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